



GOVERNOR'S TRANSACTION PRIVILEGE TAX SIMPLIFICATION TASK FORCE CONTRACTING WORKING GROUP MINUTES

Tuesday, September 18, 2012

1:30 PM

1820 W. Washington, St. #200, Conference Room 101
Phoenix, Arizona 85007

A public meeting of the Transaction Privilege Tax Simplification Task Force was convened on September 18, 2012 in Conference Room 101, 1820 West Washington, St. #200, Phoenix, Arizona 85007. Notice having been duly given. Present and absent were the following members of the Task Force.

Members Present

Tom Belshe	Steve Barela
John Olsen	Linda Stanfield
Miguel Teposte	Vince Perez
	Representative Rick Gray

Members Absent

Michael Hunter (Chair)	Lynne Herndon
Senator John McComish	Kevin McCarthy
Keely Hitt	

Others Present

Lorna Romero, Governor's Office
Craig McPike, Snell & Wilmer

1) Call to Order

Tom Belshe called the meeting to order at 1:33 p.m.

2) Presentation: Service Contracting Issues

Craig McPike, the Contracting Working Group Chair, introduced Linda Stanfield as a presenter. Ms. Stanfield presented on contracting issues in the service industry. Her presentation covered the following topics:

- A single area for service contractors to have their questions answered online.
- Unclear and time-costly applications.
- Software for easier reporting.
- Costs and time businesses incur to comply

a) Working Group Discussion and Public Comment

No comments were made.

3) Discussion of Possible Reform Recommendations

Mr. McPike called for a break at 2:18 p.m. to allow individuals to call in to the meeting. The

meeting resumed at 2:25 p.m.

Mr. McPike presented what he considers the reform options under serious consideration:

- Transitioning to a materials-based tax while allowing the cities to continue the speculative builder tax
- Adjusting revenue-sharing
- Equalizing use tax and TPT rates

b) Working Group Discussion and Public Comment

Barb Dickerson from Deloitte Tax LLP stated speculative builder is the most litigated area. It is good for attorneys, but not always easy for businesses to comply with. Ms. Dickerson asked if the group has looked at what other states have done as an alternative to speculative builder. She also asked how it could be made easier for businesses to comply with if it were kept.

Mr. McPike responded the group has not looked at other states.

Vince Perez stated not a lot of cities or states have gone from the current type of taxation to a materials-based tax.

Ms. Dickerson clarified she was asking what states did instead of speculative builder. She asked how other states fund their development of infrastructure and if there were other mechanisms.

Lee Grafstrom from the Unified Audit Committee stated in Illinois there is nothing similar to speculative builder but there is not a high reliance on sales tax. The speculative builder tax is not necessarily being used for infrastructure that it was developed for. It ends up going to the general fund to pay for more police and firemen.

Spencer Kamps from the Homebuilders Association of Central Arizona stated the speculative builder tax is problematic and offered that it may make more sense for it to be handled through a revenue sharing formula rather than one time revenue through speculative builder.

Mr. Grafstrom stated the only way for it to work would be to set up a timing structure so the Department of Revenue can see when money is coming in. It would have to capture building permits in some way because the City of Chandler would get nothing from the next Intel plant that is built. Funding is needed immediately, hence the speculative builder tax.

Mr. Kamps responded he is in agreement with Mr. Grafstrom, but stated he is less sympathetic to timing issues. He continued the Homebuilders Association of Central Arizona is willing to work with the cities.

Mr. Perez asked Mr. Grafstrom if his point was that any modification to the revenue sharing formula needs to take time into consideration.

Mr. Grafstrom stated the group is discussing 20% of sales tax revenue for most cities from contracting. The cities cannot weather a 20% reduction. It would be an immediate hit and there needs to be a backstop.

Jennifer Stielow from the Arizona Tax Research Association asked if the League has put together a list of the cities currently collecting speculative builder tax.

Mr. Grafstrom stated it is difficult to calculate and that their databases are not set up to sort different types of contractors.

Tom Belshe stated he has talked with Elaine Smith from the Department of Revenue and has given up on program cities.

Elaine Smith from the Department of Revenue stated it is difficult to sort through all of the contractors.

Mr. Grafstrom addressed Ms. Stanfield and agreed this process is a struggle for service contractors. He continued he supports letting service contractors move to a point of sale.

Mr. McPike asked Ms. Dickerson to bring up her other points they had discussed.

Ms. Dickerson stated if the proposal is that speculative builder tax be retained if it moves to a point of sale, then a working group can be created to figure out the gray areas. Speculative builder does not only affect homebuilders, retailers and investors, but sale lease backs as well.

Mr. McPike stated these conversations will most likely need to continue even after the task force has sent the final report to the Governor.

A representative from the City of Phoenix asked how services would be defined if they were carved out.

Mr. McPike responded he is not sure how to easily define it. He gave the example that there could be a contractor that performs services and is also a subcontractor on a project.

Mr. Grafstrom stated if the concept is to release trades from this issue, it has to be done through a dollar amount.

Mr. McPike stated that Mr. Grafstrom is still talking about putting two different hats on a contractor which would cause more confusion.

Mr. Grafstrom replied it would only be burdensome for a limited group of contractors, but would release hundreds of thousands of other contractors.

Mr. McPike stated it would be difficult for cities to tell which contractors have which services under a specific dollar amount. He asked if any information could be pulled to shed light on a potential threshold.

Representative Gray commented in the past there have been tweaks to make the system better but that he thinks the system needs to move all contracting to point of sale. With the service contractor only proposal, it is still complicated. Including all contracting is crystal clear. Trying to make exceptions here and there adds complexity without solving the problem.

Mr. Belshe stated if he were to build a home in the town of Eager with materials bought elsewhere then the town of Eager would lose out on revenue.

Mr. Perez responded that is the reason for making adjustments to shared revenue.

Mr. Belshe stated the origin of these materials is still unknown.

Mr. Grafstrom stated if the line were drawn at twenty-five thousand dollars per contractor, it would remove 1,211 out of 1,433 contractors in the City of Chandler.

Mr. McPike interjected that no solution is going to be perfect.

Mr. Kamps stated he recognizes the impact on cities and supports making adjustments to the distribution formula.

Mr. McPike stated the group needs to figure out a number so it can work toward a formula that addresses the delta.

Mr. Perez stated the group has only been told anecdotally that there are items purchased out of state. He asked Mr. Grafstrom if this was true.

Mr. Kamps responded he did not know if Mr. Perez wanted a notarized report from his builders, but every builder has been surveyed and all buy all of their materials in Arizona. The transportation costs for bringing materials from out of state is not worth it.

Mr. Grafstrom stated he is not trying to say he is only supportive of services and not of undoing speculative builder, but that his concern is how that is done.

Mr. McPike stated if the suppliers are in state then they should have a license to begin with. He continued that data should be available.

Mark Minter from the Arizona Builders Alliance stated these suppliers could be reporting under the retail classification.

Mark Barnes from Barnes & Associates stated he thinks a formula could be made that works, but there will be a hit to the TPT base in rural areas. He expressed concern for addressing that issue with counties. Leaving something similar to speculative builder at the state level should be considered.

Mr. McPike responded there is currently no speculative builder tax at the state level. If the group wants to discuss creating a new tax classification under the Department of Revenue that would be dead on arrival. With respect to revenue sharing adjustments, the concept is that the funds would be redistributed in a manner that gets everyone close to where they were initially.

Mr. Barnes commented he looks forward to seeing how that works out.

Phil Montalvo from the City of Scottsdale commented most cities do not allow a land deduction in

speculative builder. 25% of the price is contributed to land value.

Mr. McPike asked if Mr. Montalvo was talking about a situation where speculative builder is repealed.

Mr. Montalvo responded that if speculative builder goes away there is a land value issue.

Mr. Grafstrom stated the group needs to know what the material value is versus the contract value.

Mr. McPike commented there are a lot of issues at play.

Mr. Grafstrom stated if the group is trying to solve compliance issues, then more money needs to be given to the Department of Revenue for auditors.

Mr. Perez responded that Mr. Grafstrom is assuming a hit to the revenue pool. The Department has not crunched any numbers.

Ms. Dickerson stated noncompliance cannot be discarded. When the Anderson study was done, there was a significant amount of noncompliance when comparing all of the construction in the state versus the construction revenue. There was also abuse of exemption certificates. Current contracting revenue cannot be compared to a tax on materials. Noncompliance has to be taken into consideration on both the contracting and retail side.

Mr. Grafstrom stated that the exemption certificate issue is not seen anymore and was not seen in the last audit. No one can tell how much of an impact there will be on compliance. He continued that he needs the same amount of revenue in the new system that he has today.

Mr. McPike stated he understands Mr. Grafstrom's point and if the group is going to make progress there needs to be some level of comfort from all levels of government. He also stated the group needs data.

Ms. Stielow commented the group needs to remember the purpose is to make things easier for taxpayers to comply. The group keeps talking about revenue impacts, but no one knows what the impact will be. The group needs estimates from cities and the state.

Mr. Grafstrom stated he would ask builders the cost of their materials.

Ms. Smith commented the group needs to know where the retail transactions are happening and needs to understand which cities would gain or lose revenue.

Mr. McPike stated he would reach out to people who can collect data after this meeting.

Nicky Tate from the City of Mesa commented she has done a lot of audits on commercial and residential homebuilders and they have a very detailed cost description system. She proposed reaching out to the industry to determine their costs.

Tom Abraham from Fulton Homes stated he does not know large general contractors that get a

material breakdown from subcontractors.

Miguel Teposte stated it is impossible to agree on a percentage.

Mr. Abraham responded an average could be taken from large residential contractors.

Mr. Grafstrom stated he is looking for a ballpark number. He continued he is not opposed to any of what is being discussed, but he is looking for a way to get good things done early. Mr. Grafstrom suggested working on the service contractors first and then moving on to the other contractors. There are a lot of moving parts.

Ms. Dickerson commented that during the Anderson study surveys were done on all different trades. A good cross sample can be created if surveys are developed and consistent questions are asked. The group needs to look at gross revenue if it is going to try and exclude the service contractors.

4) Topics for Future Meetings

Mr. McPike stated the group has a relatively short timeframe to accomplish everything discussed. He suggested developing a conceptual proposal and then for the group to work together if the Governor would like to move forward.

a) Working Group Discussion and Public Comment

Steve Barela commented if Prop 204 passes the group needs to get together and figure out its implications.

Mr. McPike stated there was great conversation today and that data needs to be pulled to figure out some of the question marks. The next Contracting Working Group Meeting is October 16th.

5) Adjournment

Mr. Belshe adjourned the meeting at 4:03 p.m.